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Central Intelligence Agency

Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #42
18 July 1985Summary

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- o Balance of payments problems and large budget overruns are pushing Mexico out of compliance with IMF targets. [REDACTED] 25X1
- o Brazil's negotiations with the IMF resumed on 15 July and promise to be difficult. [REDACTED] 25X1
- o All information indicates Peru's President-elect Garcia will not immediately seek a formal IMF program. We concur with a recent US Embassy assessment that Garcia seems intent on making the debt issue a principal theme of his inaugural.
- o Castro probably believes the regional conferences Cuba is arranging will at least aggravate tensions between the US and debtor countries. [REDACTED] 25X1
- o Romania's financial situation has deteriorated in recent months, and Bucharest may need debt relief by late this year. Shortages of cash have caused Romania to be late on payments to the IMF since April. [REDACTED] 25X1

NOTE: THE NEXT REPORT WILL BE PUBLISHED ON 22 AUGUST 1985

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This situation report was prepared by analysts of the Intelligence Directorate. Comments are welcome and may be addressed to the Situation Report Coordinator, [REDACTED]

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UPCOMING IMPORTANT DATES

<u>Date</u>	<u>Event/Country</u>	<u>Comment</u>	
18 July	Paris Club (Cuba Task Force)	Meeting to discuss a rescheduling of debt owed to official bilateral creditors. [REDACTED]	25X1
18-21 July	OAU Summit (Addis Ababa)	Discussions will include the African debt situation. [REDACTED]	25X1
19 July	Paris Club (Jamaica)	Meeting to discuss a rescheduling of debt owed to official bilateral creditors. [REDACTED]	25X1
22 July	Paris Club (Equatorial Guinea)	Meeting to discuss a rescheduling of debt owed to official bilateral creditors. [REDACTED]	25X1
[REDACTED]			
28 July	Presidential Inauguration of Alan Garcia (Peru)	Visiting Heads of State and Foreign Ministers may hold informal private discussions on debt. Also, the Cartagena Group probably will meet. [REDACTED]	25X1 25X1
30 July-3 August	Latin American Debt Conference (Havana)	President Castro has invited Western Hemisphere political figures, academics and religious leaders to discuss the debt issue. [REDACTED]	25X1
12-14 August	Labor Congress Meeting (La Paz)	Bolivian Labor Confederation will sponsor a conference on Latin American debt and invite labor organizations from around the world. [REDACTED]	25X1
August	Cartagena Group Ministerial Meeting	Meeting may be arranged after the inaugurations of the governments of Peru and Bolivia at a yet-to-be-determined location. [REDACTED]	25X1

25X1

DEVELOPMENTS IN MAJOR COUNTRIES

Mexico

Rising balance of payments problems and large budget overruns are pushing Mexico out of compliance with IMF targets and may force the government to seek new foreign loans, which officials have up to now said would not be needed.

- o Mexico's oil price cut in mid-July, averaging about \$1.00 per barrel, will reduce 1985 petroleum export earnings by about \$1.5 billion from last year's level.

- o Capital flight during the first half of 1985 is double the amount for all of last year

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President de la Madrid so far has been unwilling to take the necessary measures to allow Mexico to meet its 1985 IMF targets. Slashes in investment will not bridge the widening gap between government revenues and expenditures, and the President probably will have to make unpopular personnel and subsidy cuts. We doubt de la Madrid will go far enough to satisfy the IMF, however. [REDACTED]

25X1

Mexico's stopgap measure in early July that established a free-market rate for tourist expenditures had a minimal effect on slowing the drain on foreign exchange reserves temporarily. However, we believe that Mexico will be forced soon to devalue the peso across the board. Nonetheless, even a substantial devaluation will not solve the country's financial problems especially if oil prices continue to drop. In discussions with the IMF, the Mexicans are likely to plead extenuating circumstances and ask for easier terms. Bankers probably will consider new loans only if the Fund declares that Mexico is in compliance with its IMF program. [REDACTED]

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International banks expect to complete the final phase of Mexico's \$48.7 billion debt rescheduling at the end of July. This phase covers \$20.1 billion in debt maturing between 1985-1990. The agreement will contain the controversial Mexican plan to allow foreign creditor banks to offer shares in Mexican public companies to foreign investors, with proceeds from the purchases going to the foreign bank to repay Mexican debt. [REDACTED]

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[REDACTED] Under the terms of the agreement, Mexico will complete its prepayment of \$1 billion to its creditor banks starting in September. The payments are to be made in two installments before the end of 1985. [REDACTED]

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Brazil

Brazilian officials will attempt to reach an agreement with the IMF for a standby facility when they resume negotiations with Fund representatives on 15 July, [REDACTED]

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[REDACTED] To help pave the way for an agreement, Brasilia announced measures in early July to reduce the projected \$18 billion public sector deficit for this year by 36 percent. [REDACTED]

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[REDACTED] we believe reconciliation on a new program will be difficult. [REDACTED]

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[REDACTED] there have been few new developments during recent talks with bankers regarding multiyear debt restructuring. According to the US Consulate in Sao Paulo, however, Central Bank President Lemgruber aroused creditor concerns at a luncheon with bankers late last month by raising the prospect of reopening negotiations on many issues in the debt talks that had already been resolved. Moreover, he stated in a press interview around the same time that Brazil may have to negotiate a capitalization of interest on its entire foreign debt if bank creditors do not resume voluntary lending in the future. [REDACTED]

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Argentina

Bankers report growing confidence that the \$4.2 billion jumbo loan will be fully subscribed. As of 16 July the facility was \$40 million short. We believe Argentina will be able to demonstrate sufficient compliance with its IMF targets to gain access to the first tranche of \$2.2 billion in bank funds by mid-September and IMF standby loan funds—totalling \$230 million by 15 August and another \$230 million by late-September. President Alfonsin has been successful in engendering strong public support for the wage and price freeze announced 14 June, and he appears politically stronger than at any time since his inauguration. With a clearly defined austerity program and the absence of any credible political opposition, we doubt he will backslide on his program any time soon. []

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Nevertheless, the Alfonsin stabilization program will likely face challenges in the coming months. The financial press already indicates that bankers and business analysts foresee some serious problems in retaining popular support as the economy contracts and layoffs increase. Additionally, we believe the government may continue to experience difficulty in collecting taxes, a key to reducing the deficit in the short run. []

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REGIONAL SITUATIONS

Latin America

Among other Latin American countries, Peru's President-elect continues to make debt one of his primary themes, and Chile reached an agreement in principle with the IMF for a \$765 million extended fund facility. []

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Chile

After a six-month stalemate, Chile's debt package is now moving along. The IMF agreed in principle on 15 July to a three-year, \$765 million extended fund facility, clearing the way for a 17 July Paris Club rescheduling of \$170 million, according to press reporting. []

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[redacted]

Santiago expects to receive around \$1 billion in new funds before the end of the year, according to US Embassy reporting. The government assumes that the IMF will make its first disbursement in August, bankers will begin final signing of the new loan package before September, and the World Bank cofinancing loan will be cleared and approved by October. We believe that this schedule could easily be disrupted by technical delays or resurgent political problems, in which case Chile will not receive enough foreign funds to cover its current account deficit and meet its IMF program reserve targets in 1985. Thus, we project Santiago will continue to experience foreign exchange strains this year—possibly selling off some gold reserves to meet obligations—and will seek waivers from the IMF on its reserve and inflation targets. [redacted]

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Peru

[redacted] President-elect Garcia, who will be inaugurated on 28 July, will not initially seek a formal IMF program. In recent public interviews, he has promised to pay Peru's foreign debt, but he continues to criticize the IMF approach to Latin debt problems. [redacted]

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[redacted] The party's debt expert has recently reiterated to US Embassy officials that the new administration will not sign an agreement with the Fund in the short run. [redacted]

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[redacted]

We concur with a recent US Embassy assessment that Garcia seems intent on making the debt issue a principal theme of his inaugural. His tougher line with the IMF could generate domestic acquiescence to additional belt-tightening measures. This could eventually set the stage for a self-imposed stabilization program—monitored by the IMF—that would break the current financial impasse with creditors. There is some danger, however that his adjustments will be implemented in patchwork fashion, leading to worsening economic performance over the near term. Moreover, an anti-IMF stance and rhetorical backing for unified debtor action could cause bankers to cease financial support. With exports weakening, Garcia would soon face intensified cash strains that would quickly create economic and political problems for the new government. [redacted]

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Cuba

President Castro is not obtaining support from the key debtor nations in his crusade for a Latin American debt moratorium, but he probably believes the regional conferences Havana is arranging will at least aggravate tensions between the US and debtor countries. Castro invited all the major unions in Latin America and the Caribbean to a three-day conference this week on the debt issue. [redacted]

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Mexican

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President de la Madrid recently told US officials he opposes Castro's radical approach, and Argentine Foreign Minister Caputo has termed Castro's debt moratorium proposal "dangerous". [REDACTED]

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Meanwhile, [REDACTED] hundreds of Western Hemisphere political figures, academics, and religious leaders have been invited to another debt conference in Havana on 30 July. The US Embassy in Buenos Aires reports Argentine President Alfonsin turned down Castro's invitation, and press reports indicate Colombian President Betancur also declined. [REDACTED]

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Eastern Europe

In Eastern Europe, Poland and its Western creditors signed an agreement to reschedule \$11 billion in overdue debt payments. Romania's financial situation has deteriorated and the nation is now facing a severe foreign exchange shortage [REDACTED]

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Yugoslavia

Talks between US bankers and Yugoslav officials aimed at resolving the IMF's role in monitoring Yugoslav economic performance—a major stumbling block to a multiyear rescheduling agreement—ended in New York on 13 July. [REDACTED]

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[REDACTED] Yugoslavs, and the IMF agreed that in lieu of another standby program after April 1986, the Fund would conduct enhanced monitoring consisting of two Article IV reviews annually. The Fund would measure Yugoslav trade and financial performance against as yet unspecified "trigger" criteria. If performance fell below these standards, Belgrade could be required to take policy action to correct the problem and possibly negotiate a new standby program with the Fund. The banks want the enhanced monitoring to extend through 1991 while the Yugoslavs want to limit it to 1990. [REDACTED]

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Talks with the full International Coordinating Committee to reschedule \$3.5 billion in debt maturing in 1985-88 are now expected to resume later this month. The key unresolved issues are interest rates and length of the rescheduling period. [REDACTED]

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[REDACTED] If Yugoslavia fails to reach an agreement with the banks before 15 August it will be not be able to draw the second tranche of its IMF standby credit. [REDACTED]

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Yugoslavia's hard currency account and trade deficits continue to show a sharp deterioration in comparison to 1984. The convertible currency account through April 1985 showed a deficit of \$359 compared to a \$31 surplus last year. The trade deficit of \$521 million for the first 4 months was over three times the deficit for the same period last year. Through 10 June, exports to hard currency areas were down 3 percent and imports up 9 percent from 1984. [REDACTED]

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Poland

Poland and the Paris Club of Western creditor governments signed an accord on 15 July rescheduling approximately \$11 billion in overdue debt from 1982-84 over a period of 11 years with five years grace, according to press reports. The agreement was initialed earlier this year, but formal signing was delayed when Warsaw tried to obtain new credits from the governments and failed to make required payments on arrears from

the 1981 rescheduling agreement. To implement the agreement, Warsaw must now complete payments on arrears from the 1981 agreement, sign bilateral accords with individual governments and make interest payments on the rescheduled debt. [REDACTED]

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We estimate that Warsaw can cover only about half of the \$900 million due to governments under the agreement this year if it continues to give priority to imports and paying bank creditors. The Poles will probably demand new credits in the bilateral negotiations, but Western governments seem reluctant to extend new loans. The Paris Club has indicated it will reassess the agreement if Poland cannot meet its obligations, but the governments probably would demand that Warsaw negotiate new rescheduling terms with the banks as well to ensure equal treatment of creditors. [REDACTED]

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Romania

Romania's financial situation has deteriorated in recent months, and Bucharest may need debt relief by late this year. [REDACTED]

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[REDACTED] Shortages of cash have caused Romania to be late on payments to the IMF since April. The US Embassy in Bucharest reports increasingly frequent complaints from Western firms about missed payments. [REDACTED]

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If Romania's payment problems continue to worsen, pressures to reschedule debt and renew IMF supervision will build. This would be particularly galling to President Ceausescu, who was humiliated by having to reschedule in 1982 and 1983 and has complained of IMF interference. Ceausescu may have no choice except to acquiesce because of the bleak economic outlook. [REDACTED]

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Asia

In Asia, drawings on the Philippine financial package continue to be delayed, and Korea introduced a plan to bail out some of its major banks. [REDACTED]

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Philippines

On 1 July, the Philippine government requested its eighth 90-day moratorium on all foreign debt obligations as drawings on the financial rescue package continue to be delayed and negotiations continue on rescheduling individual loan agreements. [REDACTED]

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The second tranche of IMF funds—originally scheduled to be released in April—continues to be withheld until the Managing Director can determine whether the revised end of May targets have been met. [REDACTED]

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[REDACTED]

According to Embassy reporting, however, IMF officials indicate that the program is on track and that the tranche is likely to be released on 31 July. IMF approval would allow Manila to draw the \$107 million second tranche disbursement which would in turn trigger the first release from the \$925 million new money package from the commercial creditors. After it begins drawing from the new money package, Manila would then be able to tap into the \$3 billion revolving trade credit facility. [REDACTED]

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South Korea

Korea enacted a plan to keep its major corporations and banks financially solvent. [REDACTED]

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[REDACTED]

According to Embassy reporting, in a kind of "bail out for banks" the BOK will make concessional loans to commercial banks at a 3 percent interest rate—down from the normal 6 percent. A \$17 billion special account has been established for this purpose and commercial banks will be allowed to rollover existing borrowings at the lower rate. The Korean government believes these measures will keep most of the major corporations solvent, maintain employment levels, and ensure economic growth. [REDACTED]

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The enthusiastic acceptance of a Korea Development Bank syndicated loan is indicative of bankers' continued willingness to take Korean exposure. The \$650 million facility was oversubscribed and increased from the original offer of \$600 million. The 8 year loan consists of two tranches: \$409 million at an interest rate of .625-.75 percentage point above LIBOR and \$241 million priced at the US prime rate plus .1 percentage point. [REDACTED]

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FINANCIAL BRIEFS**Americas**

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- o **Dominican Republic's** bank advisory committee formally agreed to reschedule some \$800 million in commercial debt payments...covers payments falling due 1984-1989...agreement now to be circulated to 80 member banks for pro forma concurrence. [REDACTED] 25X1
- o **Mexico** sponsored a conference on debt last week...organized by research institute...invitations to financial experts from Latin America came from de la Madrid, according to press reports...details of the meeting are not certain. [REDACTED] 25X1
- o **Panama's** bank advisory committee finally agreed to an \$877 million commercial debt refinancing package...conditional upon Paris Club rescheduling and performance under IMF standby and World Bank loan...clears way for IMF approval of new \$120 million standby. [REDACTED] 25X1
- o **Uruguay** received tentative IMF approval on its \$120 million, 18-month standby arrangement...negotiations yet to begin in earnest for new commercial bank loans to cover 1985 financing gap...Sanguinetti requesting \$25 million US bridge loan to ease cash strains and help defuse anti-IMF sentiment. [REDACTED] 25X1

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Africa/Middle East

- o **African** external debt to be discussed at OAU Summit this week...collective debt negotiation with creditors may be proposed...issue was hotly debated at preparatory meetings, unlikely to be endorsed at summit. [] 25X1
- o Paris Club rescheduled about \$300 million in official debt payments owed by **Ivory Coast**...includes all principal and half of interest payments falling due in 1985...payments spread over 9 years, including 4 years grace...Paris Club also rescheduled \$15 million owed by **Togo** this year. [] 25X1

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- o **Somalia** likely to fail 30 June IMF performance target, according to US Embassy...arrears to multilateral creditors still too high...further drawings on IMF standby would be suspended until new target negotiated. []

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- o **Zambia's** foreign exchange receipts running far below level needed to pay creditors...already behind in IMF, World Bank, and commercial bank payments...arrears to IMF will block formal negotiations on standby arrangement. []

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